

CHAPTER 3



It's Monday. A sunny morning, with the promise of getting really hot by noon. Which can mean but one thing to you, the budding beverage billionaire. It's a great day to be selling lemonade!

Last week wasn't bad, for a beginner. But from now on, well, look out world!

First, let's take a look at our last Balance Sheet.

ASSETS		LIABILITIES	
 CASH	\$13.00	NOTES PAYABLE	\$ 0.00
 INVENTORY	\$ 2.00	OWNER'S EQUITY	
		ORIGINAL INVESTMENT	\$ 5.00
		EARNINGS WEEK TO DATE	\$10.00
TOTAL ASSETS	\$15.00	TOTAL LIABILITIES & OWNERS EQUITY	\$15.00

Now, this Balance Sheet is for which week? **Last week.**

Therefore, it's what kind of Balance Sheet? **Ending Balance Sheet.**

So, this is last week's Ending Balance Sheet, and where is our ending Inventory? **In the refrigerator.**

And now it's Monday morning and you go and open up the refrigerator and what's in there? **Your lemonade, or someone has some serious answering to do!**

Let's say, for the sake of household peace, that, sure enough, your lemonade is still in the fridge. This Ending Inventory from last week becomes what kind of Inventory for this week? **Beginning Inventory, right!**

One last time: the ending Inventory automatically becomes what kind of Inventory? **Right! The Beginning Inventory for the next week.**

The Ending Balance Sheet is for last week, so we need to make what kind of Balance Sheet for the beginning of week number 2? **Beginning Balance Sheet.**

There's one more thing we need to do to convert last week's Ending Balance Sheet to this week's Beginning Balance Sheet. Do you know what that is? **The earnings.** The earnings we have were good for which week?

Last week, the first week of our business. As a result, these earnings are now what? **History.**

What are earnings that are history, or earnings from past accounting periods called? **Retained Earnings.**

Yes, Retained Earnings, and we need to make room for our earnings for when? **This week.**

We're going to take these earnings from last week and roll them up into a new category called Retained Earnings, making room for this week's earnings. We will do this to a sing-along so everyone sing to the tune of "Roll Out The Barrels." Ready? A one, and a two...

Roll up the earnings, lemons are turning to gold.

Roll up the earnings, lemons are turning to gold.

You've got your earnings rolled up. Now, you should have \$10 in Retained Earnings and zero in Earnings Week to Date. Complete the Balance Sheet below, to reflect this.

ASSETS		LIABILITIES	
 CASH		NOTES PAYABLE	
 INVENTORY		TOTAL LIABILITIES	
TOTAL ASSETS		OWNER'S EQUITY	
		ORIGINAL INVESTMENT	
		RETAINED EARNINGS	
		EARNINGS WEEK TO DATE	
		TOTAL OWNER'S EQUITY	
		TOTAL LIABILITIES & OWNER'S EQUITY	

Retained Earnings will show us all the earnings in a business from when? **From prior accounting periods.**

What exactly are Retained Earnings? We said they are earnings from past accounting periods. There are only two things that happen to earnings—you either retain them in the business or distribute them to the owners of the company. In a corporation, a distribution of earnings means the company pays a dividend to the stockholders. Earnings that have not been distributed are retained in the company.

For this week, our earnings will be recorded in Earnings Week to Date—because we always work in the current period.

Let's review. At the beginning of each new week in order to update our Ending Balance Sheet to make it a Beginning Balance Sheet we're going to do what?

Roll up the earnings and retain them in the company and convert Ending Inventory to Beginning Inventory.

Great! Now we're ready to start the new week.

As you wake Monday morning, you think, Why stay small? There's no time like the present to start growing my lemonade business.

Real businesspeople don't go on borrowing money from Mom and Dad. Real businesspeople borrow money from a real bank.

After breakfast, you put on clean clothes and brush your hair. Then you get Mom or Dad to drive you to your neighborhood bank. You show the banker your financial statements.

The banker is dressed in a really nice suit that is incapable of attracting even a speck of dust. Meanwhile, while clean, you're dressed in sneakers, jeans, and a T-shirt that says **KIDS RULE!!** As you sit in a chair that's too big, you have to remind yourself to stop kicking your legs and to sit up straight and look grownup.

"I'll be a good customer, I promise," you tell the banker in a squeaky voice. "You won't have to worry about getting your money back. I borrowed ten dollars from my parents and already paid it back."

The banker looks up and nods.

"Look at my balance sheet," you say proudly. "I have \$13.00 in cash. I have some inventory, no debt, and I started my business with five bucks and I had earnings last week of ten dollars."

The banker glances over your scorecard, and nods. "Impressive," the banker says. "There are a lot of grownup businesspeople who don't keep this good a record."

You're pretty sure the banker just complimented you, though it's hard to tell because the banker's eyebrows and lips hardly move. "Do you give loans to kids?" you ask.

"We don't discriminate because of a potential customer's age, gender, religious, racial, or ethnic identity," the banker says.

Which you're pretty sure means "Yes" to your question.

"Look at my income statement," you go on. "Last week I had sales of \$25. My gross profit was \$15, these are my expenses, with a net profit of \$10. Would you loan me \$50.00?"

Impressed, the bank loans you \$50.00 cash.

"Hey, thanks," you tell the banker. "I appreciate your interest in my business. You won't be sorry! Come by my stand on your way home." You start to leave, but you can't help but turn back and say, "You know, with an original investment of \$5 and a

net profit of \$10, that's a 200 percent return on my investment. Hey, how's the bank doing?"

Smiling, the banker wishes you well.

Now, please demonstrate what just happened on the next scorecard.

First, what comes in? **Cash.**

So bring in \$50.

ASSETS		LIABILITIES	
 CASH		NOTES PAYABLE	\$0.00
 INVENTORY		TOTAL LIABILITIES	\$0.00
TOTAL ASSETS		OWNER'S EQUITY	
		ORIGINAL INVESTMENT	\$5.00
		RETAINED EARNINGS	\$10.00
		EARNINGS WEEK TO DATE	\$0.00
		TOTAL OWNER'S EQUITY	\$15.00
		TOTAL LIABILITIES & OWNER'S EQUITY	\$15.00

Are we in balance? **No.**

Who do we owe now? **The banker for \$50.00**

Where do we show it? **Notes payable.**

Demonstrate this on the next scorecard.

ASSETS		LIABILITIES	
 CASH		NOTES PAYABLE	
 INVENTORY	\$2.00	TOTAL LIABILITIES	
TOTAL ASSETS		OWNER'S EQUITY	
		ORIGINAL INVESTMENT	\$5.00
		RETAINED EARNINGS	\$0.00
		EARNINGS WEEK TO DATE	\$0.00
		TOTAL OWNER'S EQUITY	
TOTAL ASSETS		TOTAL LIABILITIES & OWNER'S EQUITY	

Are we in balance now? **Yes!**

By the time you get home from the bank, it's already lunch. It looks like it might rain. So you decide to give yourself the rest of the day off. (It helps when you're your own boss!) But you're afraid that the lemonade in the fridge might not last until tomorrow. You decide to sell your remaining inventory for \$2.00 to your best friend at cost, for cash. Your best friend is always thirsty and loves your lemonade, so it's a win-win. The only downer to an otherwise glorious day is that, since you're home, your mom and dad insist you clean up your room.

Show the financial results of what just happened. How? By reducing inventory? **Yes, the whole thing.** But if you reduce inventory to zero, where do the two dollars go? **Well, your friend gave you two dollars, so add them to your Cash.**

ASSETS		LIABILITIES	
 CASH		ACCOUNTS PAYABLE	
 INVENTORY		TOTAL LIABILITIES	
TOTAL ASSETS		OWNER'S EQUITY	
		ORIGINAL INVESTMENT	\$5.00
		RETAINED EARNINGS	\$0.00
		EARNINGS WEEK TO DATE	\$0.00
		TOTAL OWNER'S EQUITY	
TOTAL ASSETS		TOTAL LIABILITIES & OWNER'S EQUITY	

Are we in balance? **Yes!**

What happened? The two dollars' worth of lemonade turned into what? **Two dollars in Cash.**

Did anything change in terms of total assets? **No.**

Did we have a sale? **Yes.**

We just didn't make any what? **Profit.**

Will this transaction show up on our Income Statement? **Yes.** As part of what? **Total Sales.** Make a reminder to yourself to put this into your sales total when you fill out your Income Statement at the end of the week.

After you return from your very brief vacation (interrupted by having to clean your room), you need to make up some new lemonade. You overhear Mom and Dad talking about paying their account at the grocery store, where they have a charge account. Hey, you think, maybe I can set up an account. It's worth a try, right?

You tell your parents your idea and they say it's worth a try. So, you get your bike out of the garage and pedal like crazy (watching for cars and crazy dogs, of course) down to the grocery store.

Outside, you wait to catch your breath. You check your appearance in the big window. You moisten the tips of your finger with a little spit and plaster down the hair which got messed riding your bike. Your parents hate when you use spit, but this is an emergency! After all, you want Pappy Parker, the grocer, to see an entrepreneur, not just some sweaty kid.

"Hey, Pappy," you say, entering the store. "I'm in business now, just like you. It's tough competing against the really big companies, isn't it? Us little guys need to stick together. How about one businessperson helping out another? I'd like to buy 10 pounds of sugar at 40 cents/pound, for a total of \$4.00."

"I can handle that," Pappy says with a wink. The grocer's store is a family business. It sells everything from great fresh produce to racks of snacks in one big room. Even though the place is crowded with stuff and the linoleum on the floor is, like, fifty years old, you like it better than the enormous, impersonal supermarket.

One reason is that good ol' Pappy gives every kid who comes in a free cookie! Another reason is the great customer service that Pappy and everyone else working at his store provide. The grocery staff knows every customer by name. And you'll always remember the time Pappy wouldn't let your mom buy some fruit that looked too ripe. Instead, the ol' Pap left the register and selected the best piece of fruit on display, then gave it to your mom for free. Yes sir, that Pappy sure knows how to treat his customers right!

You really like good ol' Pappy. He's like your favorite uncle—or grandpa. This gives you the courage to add, "And I'd like to purchase the sugar on credit."

"Credit? Tell me, please, why would I give you credit?"

"Well, you give my parents credit. Can I have credit too?"

"But your parents work for a living," Pappy points out.

"I'm working for a living, too," you reply. "I'm selling fresh lemonade."

"Lemonade? Is it good lemonade?" he asks.

"The absolute best, most totally awesome lemonade in this part of the galaxy," you say.

"That good? Are you trying to put me out of business?" Pappy says this with a smile. "Just the opposite," you quickly respond. (It amazes you that every so often the ol' brain charges in with a great reply!) "After all, the more lemonade I sell, the more lemons and sugar I'll need to buy from you. Plus maybe paper cups and napkins. And maybe one day I'll add cookies, which I'll get from your bakery because they're the best around." You run out of great ideas and hope it's enough to win over Pappy.

He lives in the neighborhood and always gives free stuff to your school. Pappy's known you and your family for a long time.

"Well, it sounds like you figured it all out," he observes. "Maybe one day you'll help me out with my business?"

"You'll give me credit?" you ask hopefully.

"I'll give you \$4.00 in credit," Pappy says, handing you a piece of paper to sign. Home, you unpack the grocery sack. What financial category is packed inside?

Inventory.

What kind of inventory? **Sugar.**

How much sugar? **\$4.00.** What color? **White—just checking!**

Did you pay CASH for the sugar? **No!** Is this a great country, or what?!


Do we owe money? **Yes.**

In order for the grocer to keep track of the credit, what have we set up? **An account.**

And it's payable to whom? **The grocer.**

What do businesses call this sort of thing? **ACCOUNTS PAYABLE.**

So, now we have our second kind of liability. We had the note with the banker and now the account set up with the grocer. Demonstrate this latest transaction below.

ASSETS		LIABILITIES	
 CASH		ACCOUNTS PAYABLE	
 INVENTORY		NOTES PAYABLE	
TOTAL ASSETS		TOTAL LIABILITIES	
		OWNER'S EQUITY	
		ORIGINAL INVESTMENT	
		RETAINED EARNINGS	
		EARNINGS WEEK TO DATE	
		TOTAL OWNER'S EQUITY	
TOTAL LIABILITIES & OWNER'S EQUITY			

What's the difference between the two kinds of liabilities?

The Notes Payable from the bank shows that the bank gave you what? **Money!** And the Accounts Payable with the grocer shows that the grocer gave you what? **Sugar or Inventory.**

So, is it fair to say that Notes Payable has to do with money owed to someone else for money received, and Accounts Payable has to do with some things we got for our business which we have to pay for someday? **Yes.** In other words, for Notes Payable we got cash and for Accounts Payable we got goods or services.

There is another difference between Notes Payable and Accounts Payable. It has to do with time. Generally speaking, a loan from a bank (Notes Payable) and a credit account (Accounts Payable) from a store have different payback periods. In other words, one is for a short time and one is for a longer time.

Which is which? **Accounts Payable is short-term, usually due in full in maybe thirty days. Notes Payable is long-term, maybe several years. That's why Accounts Payable is the first item in Liabilities—they are generally ordered as they come due.**

Any other difference? **HINT:** What's one thing all bank loans come with that store credits generally don't come with providing you promptly pay off your balance? **Interest!**

Which has interest? **Notes Payable. Usually, Accounts Payable does not have interest unless you don't pay on time.**

In both cases, we're establishing what? **Credit!** Hey, we're pretty sharp entrepreneurs! Or at least a lot like Mom and Dad and most other businesses and consumers! We owe people money! Talk about feeling grownup!

Now that we have some credit, it's time to buy some other supplies. You buy 100 lemons at 20 cents/lemon. You want to keep in good with the grocer so you pay in cash.


The amount goes out of Cash, and into...what? **Inventory.**

How much inventory? **Twenty dollars in lemons come in.**

Again, what did we do? We exchanged \$20.00 in cash for what? **Twenty dollars in inventory.**

Did we, in fact, exchange one asset for another. **Yes.**

Bring the next scorecard up to date, reflecting these transactions.

ASSETS		LIABILITIES	
 CASH		ACCOUNTS PAYABLE	
 INVENTORY		NOTES PAYABLE	
TOTAL ASSETS		TOTAL LIABILITIES	
		OWNER'S EQUITY	
		ORIGINAL INVESTMENT	
		RETAINED EARNINGS	
		EARNINGS WEEK TO DATE	
		TOTAL OWNER'S EQUITY	
TOTAL LIABILITIES & OWNER'S EQUITY			

Are we in balance? **Yes.**

You should have \$69 in Assets, \$54 in Liabilities, and \$15 in Equity; the sum of the right side total is \$69.

You're doing great. You're especially patient with all this record-keeping stuff. But, believe me, you'll be glad later.

Now that our financial record-keeping is up to date, it's time to take a break (if you wish). Then, let's make up a fresh batch of the world's greatest lemonade!